



STATE OF CONNECTICUT  
DEPARTMENT OF REVENUE SERVICES

**PS 2001(12)**

25 Sigourney Street  
Hartford CT 06106-5032

**POLICY STATEMENT**

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## **Production of Prewritten Software**

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**Purpose:** This Policy Statement describes the Connecticut sales and use tax treatment of purchases made in connection with designing, developing, and producing prewritten software for sale.

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**Effective Date:** Effective upon issuance and applicable to all open tax periods.

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**Statutory and Regulatory Authority:** Conn. Gen. Stat. §12-407(13) and (35); Conn. Gen. Stat. §12-412(18) and (34); Conn. Gen. Stat. §12-412i; and Conn. Agencies Regs. §12-412(34)-1.

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### **Definitions:**

- *Tangible personal property* means personal property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses including canned or prewritten computer software.
  - *Canned or prewritten software* means all software, other than custom software, that is held or existing for general or repeated sale, license or lease. Software initially developed as custom software for in-house use and subsequently sold, licensed or leased to unrelated third parties shall be considered canned or prewritten software.
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**Software Production:** Machinery purchased for use directly in the mass duplication of prewritten software on magnetic, optical, or similar media qualifies for exemption under Conn. Gen. Stat. §12-412(34) when the remaining requirements for the exemption for machinery used directly in a manufacturing production process, set out in Conn. Agencies Regs. §12-412(34)-1, are met. Computers and computerized machinery used

directly in the mass duplication of prewritten software qualify as machinery used directly in manufacturing for purposes of the exemption.

Conn. Agencies Regs. §12-412(34)-1(c) defines manufacturing as:

“an operation or an integrated series of operations that substantially transform, by physical, chemical or other means, the form, composition or character of raw or finished materials into a product possessing a new name, nature and use which is intended for sale.”

(See also **Informational Publication 99(18)**, *Sales and Use Taxes Guide for Manufacturers, Fabricators and Processors*.) The mass duplication of prewritten software satisfies the *substantial transformation* requirement because encoding a program or data onto a blank medium (such as a CD-ROM or floppy disk) gives that medium a new name, nature, and use, in that the blank medium has become software capable of performing a computer program and is valued as such.

Note that the exemption for manufacturing machinery requires that the production of tangible personal property to be sold take place in a manufacturing plant, as defined in Conn. Agencies Regs. §12-412(34)-1(e), which does not include cottage industries. *Cottage industries* are establishments at which manufacturing takes place in a residential dwelling or in a building on the grounds of a residential dwelling. If an establishment is not located in an area zoned as commercial or industrial, or if residential use is among the uses being made of the establishment, it is less likely to be a manufacturing plant.

The blank media on which the prewritten software is duplicated are exempt under Conn. Gen. Stat. §12-412(18) as materials that become an ingredient or component part of tangible personal property to be sold.

**Machinery Used for Software Design and Development:** Conn. Agencies Regs. §12-412(34)-1(c) provides that the development of software programs is not manufacturing. Thus, machinery purchased for use solely in software design and development does not qualify for the full exemption for manufacturing machinery. (See also *Machinery Used for Design and Development and for Mass Duplication*, below.)

The Manufacturing Recovery Act of 1992 (the MRA), Conn. Gen. Stat. §12-412i, provides a partial exemption for items used in manufacturing, processing, or fabricating tangible personal property. Although the partial exemption extends to machinery and equipment used in “research and development,” that term is defined as an experimental or laboratory activity in **Special Notice 93(1.1)**, *The Manufacturing Recovery Act of 1992 Exemption for Purchases of Property Used in Manufacturing, Processing and Fabricating*. Because software design and development are not experimental or laboratory activities, they do not qualify for the partial exemption of the MRA.

**Machinery Used for Both Design and Development Activities and Mass Duplication:** A machine that is used for designing and developing prewritten software and for its mass duplication may still qualify for full exemption under Conn. Agencies Regs. §12-412(34)-1(f)(3). The regulation provides that a machine used *exclusively* to design a product, as well as to control or monitor an activity occurring during the manufacturing production process, and that is directly linked with machinery described in subdivision (1) or (2) of this subsection, is used directly in a manufacturing production process. Note that *any* other use of the machine, such as administrative or personal use, disqualifies the machine from exemption under Conn. Gen. Stat. §12-412(34).

The partial exemption of the MRA may apply to a machine that is used for purposes in addition to software design and development and mass duplication. The MRA applies to machinery used *primarily* in manufacturing tangible personal property.

*Primarily* means the greatest use among all uses. For example, if the same computer is used 45% of the time in mass duplicating prewritten software, 25% of the time in developing the prewritten software, and 30% of the time in designing custom software, the computer can qualify for partial exemption.

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**Effect on Other Documents:** None affected.

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**Effect of This Document:** A Policy Statement is a document issued by the Department of Revenue Services (DRS) that explains in depth a current position, policy, or practice affecting the tax liability of taxpayers.

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**For Further Information:** Please call DRS during business hours, 8:00 a.m. to 5:00 p.m., Monday through Friday:

- **1-800-382-9463** (toll-free within Connecticut), or
- **860-297-5962** (from anywhere)

**TTY, TDD, and Text Telephone users only** may transmit inquiries 24 hours a day by calling 860-297-4911.

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**Forms and Publications:** Forms and publications are available all day, seven days a week:

- **Internet:** Preview and download forms and publications from the DRS Web site: **[www.drs.state.ct.us](http://www.drs.state.ct.us)**
- **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu.
- **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (toll-free within Connecticut) and select **Option 2** from a touch-tone phone.